

WD74900

**IN THE MISSOURI COURT OF APPEALS
WESTERN DISTRICT**

**JONATHAN D. EILIAN and
AMANDA A. EILIAN,**

Respondents (Petitioners below),

vs.

**DIRECTOR OF REVENUE,
STATE OF MISSOURI,**

Appellant (Respondent below).

**From the Administrative Hearing Commission of Missouri,
The Honorable Nimrod T. Chapel, Jr., Commissioner**

APPELLANT'S REPLY BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES	ii
ARGUMENT	1
CONCLUSION.....	3
CERTIFICATION OF SERVICE AND COMPLIANCE.....	5

TABLE OF AUTHORITIES

CASES

Brown Group, Inc. v. Administrative Hearing Commission,
649 S.W.2d 874 (Mo. banc 1983) 1, 2

M.F.A. Central Cooperative v. Bookwalter,
427 F.2d 1341 (8th Cir. 1970)..... 1

STATUTES

§ 143.121..... 2

§ 143.431..... 1

§ 143.431.4..... 1

ARGUMENT

There is no statutory provision necessary to establish that taxpayers are not entitled to double recovery on a tax deduction. Yet, that is the import and effect of the Eilian's arguments. Indeed, quite the contrary is the case. It is the Eilians that must show from the statutory language that they are specifically entitled to the deductions they claim, and the double benefit they produce. They cannot.

In *Brown Group, Inc. v. Administrative Hearing Commission*, 649 S.W.2d 874 (Mo. banc 1983), the Missouri Supreme Court rejected a result that would allow “multiple benefits arising from a single loss.” *Id.* at 877. The basis for the court's reasoning was that “[d]eductions depend upon legislative grace and are allowable only to the extent authorized by statute.” *Id.* (quoting *M.F.A. Central Cooperative v. Bookwalter*, 427 F.2d 1341, 1344 (8th Cir. 1970)). Although the taxing structure for corporate income taxes in Missouri was later changed (20 years later), the principles of *Brown Group* remain; namely, that there are situations where adjustments must be made to prevent unintended benefits.

Furthermore, the amendment, decades later, to § 143.431 did not overturn *Brown Group* and allow a corporation to benefit twice from the same loss. The amendment was part of an overall adjustment that changed the manner and timing of the taxation of addition modifications for corporations. See § 143.431.4, RSMo (2012 Cum. Supp.). Because the calculation for Missouri tax for corporations begins with federal taxable income, there is no discrepancy in the calculation of the

starting point for Missouri purposes and the actual utilization of the net operating loss (“NOL”) at the federal level in the applicable tax year. It is a problem unique to the individual income tax scheme, such as in this case, and the legislature chose NOT to amend the corresponding statute for calculating individual adjusted gross income in § 143.121.

The relevant question in this case is: may a taxpayer be allowed to benefit twice from the same loss? In particular, the question is how to treat a negative amount of income reported on the first line of a return when that negative income amount allows the taxpayer a benefit at the Missouri level that was not truly allowed at the federal level. *Brown Group* recognized that the statutes did not address this situation (or permit it), and there has been no change to that principle.

The fundamental problem is the starting point. The Eilians included the entire amount (\$35,429,672) of the NOL carried forward from 2005 to 2006 in calculating their 2006 federal adjusted gross income (“FAGI”). They were limited, however, in the amount used to offset their 2006 federal income. The Eilians do not deny that at the federal level they utilized \$28,418,457 of the 2005 NOL in 2006 and \$6,117,375 of the 2005 NOL in 2007. The specific NOL amount used in 2006 was dictated by the Eilians’ modified taxable income, not by FAGI. Yet, Missouri *begins* the calculation of tax with FAGI, an amount calculated by including the entire amount of the 2005 NOL carried forward to 2006. Because of this discrepancy between the amount of 2005 NOL included in the calculation of the

2006 FAGI, and the amount of 2005 NOL actually utilized in 2006 at the federal level, Missouri must make an adjustment to properly reflect this difference.

Furthermore, the effect of absorbing the 2005 NOL in 2006 shows that the Eilians did not utilize \$123,539 of federal itemized deductions in 2006. For 2006, the Eilians' modified taxable income was \$28,418,457; therefore \$28,418,457 of the 2005 NOL was absorbed in 2006, leaving \$6,117,375 of the 2005 NOL to be carried over to 2007. This is also illustrated on the face of the Eilians' federal Form 1040. The Eilians' FAGI as reported on line 37 was -\$5,993,836. After subtracting itemized deductions of \$123,539 from FAGI, the Eilians reported -\$6,117,375 on line 41. Conceptually, this means the Eilians did not have to use their itemized deductions against income in 2006 and instead that amount essentially becomes part of the Eilians' NOL carryover to the next taxable year. This is inconsistent with the principles of *Brown Group* and should be rejected by this Court.

CONCLUSION

For the foregoing reasons, as well as those set forth in Appellant's Opening Brief, this Court should reverse the decision of the Administrative Hearing Commission in favor of the Director of Revenue and against Jonathan D. and Amanda A. Eilian.

Respectfully submitted,

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CERTIFICATION OF SERVICE AND COMPLIANCE

I hereby certify that on the 1st of November, 2012, the foregoing brief was filed electronically via Missouri CaseNet and served electronically to:

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I further certify that the foregoing brief complies with the limitations contained in Rule No. 84.06(b) and that the brief contains 796 words.

/s/ Jeremiah J. Morgan
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